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IN THE
Supreme Court of the United States

OCTOBER TERM, 1938.

No. 169.

THE UNITED STATES, *Petitioner,*

v.

FREDERICK PLEASANTS.

On a Writ of Certiorari to the Court of Claims.

**BRIEF AS AMICUS CURIAE IN BEHALF OF
HOWARD HEINZ.**

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PRELIMINARY STATEMENT.

Howard Heinz is the petitioner in the case of *Heinz v. Commissioner of Internal Revenue*, 94 F. (2d) 832, which is presently pending before the United States Circuit Court of Appeals, Third Circuit, on petition for rehearing, and also involves the 15 per cent limitation prescribed by Sec-

tion 23 (n) on the amount allowable as a deduction for contributions to charitable institutions.

Howard Heinz made contributions in 1931 of \$45,910.37 and in 1932 \$51,571.40, of which the Commissioner of Internal Revenue only allowed \$28,031.86 for 1931 and \$4,987.64 for 1932 as deductions for income tax purposes.

His *net income* subject to tax under Sections 11 and 12 of the Revenue Acts of 1928 and 1932, as computed without the benefit of the deduction for contributions, was \$375,844.65 for 1931 and \$412,017.69 for 1932. If these amounts constitute the base for the calculation of the 15 per cent limitation, Heinz's contributions are deductible in full.

Heinz sustained a *capital net loss*, as defined by Section 101 (c) (6), of \$186,965.56 in 1931 and \$378,766.79 in 1932, which amounts were not permissible deductions in computing the *net income* as aforesaid, and were not allowed as deductions by the Commissioner in computing the net which was taxed.

The Commissioner of Internal Revenue for the year 1931 only allowed as a deduction for contributions \$28,031.86, being 15 per cent of \$186,879.09, representing the difference between the *net income* subject to tax for that year of \$375,844.65 as computed before the deduction for contributions, and the *capital net loss* of \$186,965.56, and for the year 1932 he only allowed as a deduction for contributions \$4,987.64, being 15 per cent of \$33,250.09, representing the difference between the *net income* subject to tax for that year of \$412,017.69 as computed before the deduction for contributions and the *capital net loss* of \$378,766.79.

In the computation of the *net income* subject to tax under Sections 11 and 12 the Commissioner of Internal Revenue did not allow the *capital net loss* as a deduction, because Congress in the Revenue Acts of 1928 and 1932 expressly excluded it. The Commissioner of Internal Revenue levied the normal and surtaxes prescribed by Sections 11 and 12 on the *net income* as computed without the benefit of any deduction for the *capital net loss*, and properly so, and

against the taxes thus determined, a credit was allowed pursuant to Section 101 (b) of $12\frac{1}{2}$ per cent of the capital net loss, the difference representing the tax due.

Heinz paid an income tax of \$25,802.90 for 1931 and \$108,842.23 for 1932. In addition thereto, there are outstanding deficiencies in income tax of \$8,115.91 for 1931 and \$22,633.73 for 1932, which deficiencies are in the main ascribable to the action of the Commissioner of Internal Revenue in cutting down on the deduction for contributions.

ARGUMENT.

The base for measuring the 15 per cent limitation on the deduction for contributions is the net income subject to tax, as computed without the benefit of the deduction, and not such amount diminished by a non-deductible capital net loss.

Section 23 (n) of the Revenue Acts of 1928 and 1932 expressly provided that in computing *net income* there shall be allowed as a deduction charitable contributions made within the taxable year ~~to~~ an amount which does not exceed 15 per cent of the taxpayer's *net income*, as computed without the benefit of the deduction. Its purpose was to encourage contributions to charitable institutions by according taxpayers a saving in tax through the medium of a deduction, and the statute therefore should be so construed to carry out this legislative plan.

The term "net income," is a statutory concept, and consists of gross income less authorized deductions. Its purpose was to provide a definite *base for the calculation of the tax*. The taxable base, as computed without the deduction for contributions, is the base contemplated by Section 23 (n) for the calculation of the 15 per cent limitation on the amount allowable as a deduction for contributions.

Article 41 of Regulations 77 under the 1932 Act provides as follows:

"Art. 41. Meaning of net income.—The tax imposed by the Act is upon income. . . ."

The *net income* as computed by the Commissioner of Internal Revenue without the deduction for contributions as the base for the calculation of the normal and surtaxes prescribed by Sections 11 and 12 in the *Heinz* case was \$375,844.65 for 1931 and \$412,017.69 for 1932, and these amounts undiminished by the nondeductible *capital net loss* should afford the base for the calculation of the 15 per cent limitation.

The Commissioner did not deduct the *capital net loss* in arriving at the *net income* subject to tax under Sections 11 and 12, and therefore should not be permitted to deduct the *capital net loss* in ascertaining the *net income*, the base specified by Section 23 (n) for the calculation of the 15 per cent limitation. A *capital net loss* is not a permissible deduction in the computation of taxable net income. (*Piper v. Willcuts* (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397; *Hoffman v. Commissioner* (CCA 2), 71 F. (2d) 929.)

The Commissioner determined the net income subject to tax under Sections 11 and 12, as computed without the deduction for contributions, to be \$375,844.65 for 1931 and \$412,017.69 for 1932, but in the calculation of the 15 per cent limitation, however, the Commissioner used \$186,879.09 for 1931 and \$33,250.09 for 1932 as the base for measuring the limitation and thereby reduced the deduction for contributions. The amounts \$186,879.09 for 1931 and \$33,250.09 for 1932 represented the difference between the taxable *net income* as aforesaid and the nondeductible *capital net loss*, but were not used by the Commissioner as the *net income* in the imposition of taxes. The aforesaid amounts were in no sense the *net income* under the Acts for purposes of taxation. The Commissioner only used the said amounts for the purpose of Section 23 (n) in cutting down on the deduction for contributions. For the purpose of levying the normal and surtaxes prescribed by Sections 11 and 12, he used the enlarged *net income*. A taxpayer can only have one *net income* under the Act for a particular taxable year and that *net income* is the base for the calculation of the taxes.

The nondeductibility of a *capital net loss* in ascertaining taxable *net income* disadvantages a taxpayer. The capital net loss provisions in the statute were designed to protect the revenues of the Government, because the exclusion of a *capital net loss* served to increase taxable net income, and, therefore, taxes. Congress in the process of enlarging net income for the imposition of taxes evinced no intent to contract or destroy *net income* in the calculation of the deduction for contributions through the medium of deducting from gross income a nondeductible *capital net loss*. Such a course runs counter to the history of the legislation, and produces a contradiction not intended by Congress.

The fallacy of the Commissioner's view of the statute is clear when it is considered that Heinz paid an income tax of \$108,842.23 on taxable net income for the year 1932, yet the Commissioner maintains that his *net income* for the purpose of Section 23 (n) is only \$33,250.09. Congress without question contemplated that the *net income* which was the base under the Act for the imposition of taxes, as computed without the deduction for contributions, was also the base for the calculation of the 15 per cent limitation on the deduction for contributions, otherwise inconsistent meanings must be ascribed to the term *net income*.

While *Helvering v. Bliss*, 293 U. S. 144, did not involve the issue which is presented by the case at bar, and, therefore, is not controlling, that case, however, does afford light in the solution of the present question. That case held that the base for the calculation of the 15 per cent limitation was the total net income subject to tax, as computed without the benefit of the deduction for contributions, which in that case consisted of two parts (1) *net income* denominated by the Act as ordinary net income, subject to tax under Sections 11 and 12, and (2) *net income* consisting of capital net gain, subject to the 12½ per cent tax prescribed by Section 101. The total of these two parts represented the base for the calculation of taxes and was held to be the base for the calculation of the 15 per cent limitation. The base

in the case at bar for the calculation of taxes consists of only one part *ordinary net income*, which is the taxpayer's sole net income, and, therefore, is the correct base for measuring the 15 per cent limitation here.

Section 101 (c) (7) provides:

"(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

Section 101 (c) (7) expressly denominated ordinary net income as *net income*. If it were not net income, it could not have been taxed under Sections 11 and 12. These sections authorize a tax on *net income*. The Commissioner of Internal Revenue subjects the ordinary net income undiminished by the nondeductible *capital net loss* to tax under Sections 11 and 12 as the *net income* contemplated by those sections. Since it is the *net income* for the purpose of Sections 11 and 12, it follows that it is also the *net income* for the purpose of Section 23 (n). The purpose of Congress in fixing *net income* was to arrive at a base for the calculation of taxes, and it is that base, as computed before the deduction for contributions is taken, which measures the 15 per cent limitation. The taxable *net income* less the nondeductible *capital net loss* is not the base used in the calculation of taxes, and, therefore, is not the correct base for ascertaining the 15 per cent limitation.

Section 21 of the Revenue Act defined "net income," to mean the gross income computed under Section 22, less the deductions allowed by Section 23. The general statutory concept of net income was covered by these sections. The existence of income tax liability depends on the existence of statutory net income within the meaning of that term as used in Section 21. Sections 11 and 12 lay a tax on net income. These sections could not operate on the subject matter unless net income existed within the meaning of that term as used in Section 21. Section 101 (c) (7) denomi-

ates ordinary net income as net income. It must be net income within the meaning of that term as used in Section 21, otherwise it could not have been treated as net income by the Commissioner for the purpose of imposing the tax prescribed by Sections 11 and 12.

The general language of Sections 22 and 23 was to some extent modified by special language contained in later sections of the Act, all part of Title I of the Act. For example, Section 118 prohibited the deduction of a loss under Section 23 (e) on the sale of securities where within 30 days before or after the sale the taxpayer has acquired substantially identical property. Section 120 provides that the 15 per cent limit imposed by Section 23 (n) on the deduction for contributions does not apply under certain circumstances. There are many others that affect the computation of the net which is taxed.

General language in a statute must always yield to special language that covers a particular subject. *United States v. Chase*, 135 U. S. 255, 260; also *Ginsberg & Sons v. Popkin*, 285 U. S. 204.

A taxpayer is only entitled to such deductions from gross income as are authorized. In *Helvering v. Independent Life Ins. Co.*, 292 U. S. 371, 381, this Court said:

"Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax."

Congress by Section 23 (e) did not authorize a deduction of a capital net loss. A capital net loss is the excess of losses over gains on sales of capital assets. Congress specially legislated against such a deduction in computing the net that it chose to tax. If it were deductible under Section 23 (e) why didn't the Commissioner allow it?

The term "ordinary net income," as defined by Section 101 (c) (7) means the same thing regardless of whether a taxpayer had a capital net gain, or a capital net loss. The term cannot have conflicting meanings. The same method

of arriving at ordinary net income must be used in each type of case. If the deduction for contributions is an ordinary deduction to be taken in whole from ordinary net income in a *capital net gain* case, as was held in the *Bliss* case, *supra*, it is likewise an ordinary deduction to be taken in whole from ordinary net income in a *capital net loss* case. There is no cogent reason for differentiation, and the statute suggests none. The legislative objective of the capital net loss provisions was to deny a deduction of a capital net loss in computing the net income subject to the normal rates of 4 and 8 per cent, and surtax rates of 1 to 55 per cent under Sections 11 and 12 of the Revenue Act of 1932. This disadvantaged the taxpayer, but advantaged the revenues of the Government. The statute does not contain any suggestion that Congress wanted to further augment the revenues of the Government by denying or cutting down on the deduction for contributions.

The cases of *Elkins v. Commissioner*, 24 B. T. A. 572, and *Livingood, Executor v. Commissioner*, 25 B. T. A. 585, dealing with capital net loss, should not be confused with cases dealing with capital net gain. In each case, it is only necessary to determine the taxpayer's *net income*. A taxpayer who has a capital net gain has a net income which is different from that existing in a capital net loss case.

The Commissioner's administrative practice on the question at issue has been confusing. I. T. 2104 did not provide that in computing net income, a *capital net loss* is deductible. I. T. 2104 dealt only with capital losses. Capital losses are deductible from capital gains in determining capital net gain subject to the 12½ per cent tax. Capital losses are deductible to the extent of capital gains in ascertaining a capital net loss. The excess of the losses over gains constitutes a capital net loss. I. T. 2104 does not hold that a capital net loss is deductible in computing a net loss which is deductible under Section 206 of the Revenue Act of 1924. Section 206 (a) (2) provides that in computing a net loss:

"In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;"

The excess represents a capital net loss which is not deductible. The Commissioner has never allowed a *capital net loss* as a deduction, and L. T. 2104 does not deal with that subject.

The administrative practice is not helpful to the Commissioner. Where the department decides a question two ways, neither decision can be given the effect usually given to an established practice of an executive department. *U. S. v. Coulby*, 258 Fed. 27. In *The Dollar Savings Bank v. U. S.*, 86 U. S. 227, it was held that where an Internal Revenue Act was not susceptible of the construction given to it by the Commissioner of Internal Revenue, the reenactment of the statute subsequent to the construction placed thereon was not to be regarded as a legislative adoption of that construction. This Court, speaking through Mr. Justice Strong, said (p. 237):

"* * * Hence, it is inferred, the construction given by the commissioner was adopted. It is, doubtless, a rule that when a judicial construction has been given to a statute, the re-enactment of the statute is generally held to be in effect a legislative adoption of that construction. This, however, can only be when the statute is capable of the construction given to it; and when that construction had become a settled rule of conduct. The rule, we think, is inapplicable to this case. In the first place, the decisions of the internal revenue commissioner can hardly be denominated judicial constructions. That officer was not required by the law to prescribe what returns savings banks were required to make. That was prescribed by the Act of Congress itself, and he had no power to dispense with the requisition. There is, therefore, no presumption that his decisions were brought to the knowledge of Congress when the act of 1870 was passed. And again, the construction he gave is an impossible one, for, as we have seen, it makes the proviso plainly repugnant to the body of the section."

If legislative adoption of a prior construction has been here, then the taxpayer has greater standing. *Elkins Commissioner*, 24 B. T. A. 572, was decided in favor of taxpayer on the issue in question on November 3, 1931, *Livingood, Executor v. Commissioner*, 25 B. T. A. 585, in favor of the taxpayer, was decided February 23, 1932, Congress by Section 23 (n) of the Revenue Act of 1932, approved June 6, 1932, reenacted Section 23 (n) of the Revenue Act of 1928 authorizing a deduction for contribution in the same language, and in the face of the prior construction by the Board of Tax Appeals.

CONCLUSION.

In conclusion, we submit that the decision below in *Pleasants v. U. S.*, 22 F. Supp. 964, is a correct interpretation of the statute, and should be affirmed.

Respectfully submitted,

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